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IN THE

Supreme Court of the United States

October Term, 1969
No. 152

ANGELUS FUNERAL HOME, a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in the above-entitled case on February 10, 1969.

Opinions Below.

The within cause was a petition in the United States Court of Appeals for the Ninth Circuit [I T. R. 52 *et seq.**] to review a judgment of the Tax Court adverse to the petitioner. [I T. R. 28 *et seq.*] The opinion of the Tax Court is reported in 47 T.C. 391, and a copy thereof is attached hereto as Appendix A. The opinion of the United States Court of Appeals for the Ninth Circuit, affirming the decision of the Tax Court, is not yet reported; a copy thereof is attached hereto as Appendix B.

*Signifying Volume I of the Transcript of Record, pages 52 *et seq.*

Jurisdiction.

The judgment of the Court of Appeals for the Ninth Circuit was entered on February 10, 1969 [I T. R. Supp.*] A timely petition for rehearing was filed on February 24, 1969, and an order denying the said petition for rehearing was made and entered February 27, 1969. [I T. R. Supp.]

The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

Question Presented.

The question presented in the instant case is whether certain deposited sums deposited with the taxpayer under certain pre-need funeral services agreements (identified herein as the "1961 agreement-form"), where such sums during an interim period until each depositor's death were subject to conditions and contingencies rendering unknown and indeterminable whether the same would ultimately be income or be refundable, and where during such interim the funds were required to be held under a written, enforceable trust, permitting only limited powers of investment in trust as herein described, were taxable to the taxpayer as income at the time of receipt and while held in such interim trust holdings.

Statute Involved.

The statutory provision involved in the instant cause is Section 61 of the Internal Revenue Act of 1954, 26 U.S.C., Section 61. A copy of said statute is attached hereto as Appendix C.

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*Signifying the Supplement to Volume I of the Transcript of Record incorporating the proceedings in the Court of Appeals; petitioner's copy of this Supplement carries no pagination.

Statement of the Case.

Petitioner is a California corporation located in the City and County of Los Angeles and is and at all times material herein has been engaged there in the business of furnishing funeral and burial services and, concurrent therewith, selling caskets. [I T. R. 23 (stipn.); 28 (fdg.)*.] Petitioner reports its income on a calendar year and on an accrual basis. [I T. R. 28, 30 (fdg.).]

The sole question at bar is the taxability as income to petitioner at the time of receipt of deposits paid to it under certain "Pre-Need Funeral Plan Agreements", and specifically the deposits made under what is herein designated as the "1961 agreement-form."

Many of the members of the community served by petitioner have been persons of small means. [II T. R. 23-25**; I T.R. 28, 30 (fdg.)] As a regular part of its business since approximately 1954 Angelus has encouraged such persons to enter into its "Pre-Need Funeral Plan Agreements" which require only small—even nominal—down payments, and which provide thereafter for only *voluntary* subsequent payments, but which serve at least to record a plan and agreement for the depositor's funeral and casket. [*Id.*]

These agreements were in two forms, an original form herein identified as the "pre-1961 agreement-

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*The facts in the instant case are virtually without contest and as set forth herein are taken almost entirely (except where noted) from two concurrent sources: (1) The Tax Court's "Findings of Fact", appearing in Volume I of the Transcript of Record at pages 28 *et seq.*, and identified herein in citations as: "(fdg.)", and (2) the "Stipulation of Facts" filed by the parties in the Tax Court and appearing in Volume I of the Transcript of Record at pages 23 *et seq.*, and identified herein as: "(stipn.)".

**Signifying Volume II of the Transcript of Record, pages 23-25.

form", a true copy of which appears in the Record as Petitioner's Exhibit 10 [I T. R. 59 *et seq.*] and a copy of which is also attached hereto as Appendix D, and an amended form identified herein as the "1961 agreement-form", a true copy of which appears in the Record as Petitioner's Exhibit 11 [I T. R. 63 *et seq.*] and a copy of which is also attached hereto as Appendix E. In all respects save one, which will be stated hereafter, these agreement-forms were (in substance) identical.

As stated, the down payments and subsequent voluntary periodic payments under these deposit agreements were small. The Tax Court found that the agreements called for "small down payments" followed thereafter by "small amounts each month." [I T. R. 28, 30 (fdg.).] The representative sample of such agreements appearing as Petitioner's Exhibit 10 provided for a down payment of but $2.00 and for a monthly payment thereafter of $5.00, upon an agreement projecting a funeral and casket of a total cost of $465.00.

The agreements obligated Angelus to hold the deposits "in irrevocable trust" until the depositor's death and then, in the absence of stated contractual and economic contingencies hereafter discussed, to apply the deposited sums to the furnishing of funeral services and a casket "of the reasonable value equal to" the deposited money at time of death. [Exhibits 10 and 11, *supra*, pars. 2 and 4.]

After the initial down payment, all subsequent payments under the agreements were made expressly *voluntary* and *unenforceable*. The agreements provided in paragraph 3:

> "3. The parties agree that nothing herein contained shall be construed to vest in ANGELUS

the right to sue for or otherwise demand payment of any sum payable by Applicant under the terms hereof which is *not voluntarily paid by him.*"

—Petr's Ex. 11, par. 2, emphasis added; cf. Petr's Ex. 10, par. 3.

As Petitioner's president, Mr. John L. Hill, testified in uncontradicted testimony, "many of these" preneed deposit agreements "are one dollar deposited, residue to come at some date, if and when." [II T. R. 24.]

Although the agreements gave the depositors during their lifetime no express right to withdraw part or the whole of the moneys deposited, since all of the payments provided for were voluntary and the whole program depended upon voluntariness for its success, it was the uncontradicted testimony of Mr. Hill that requests for withdrawals were frequently made because of "hardships, illness . . . [or] rent", and all such requests were *unvaryingly honored.* [II T. R. 25.]

The contract terms provided one express contingency requiring refund. Paragraph 7 of the agreements provided that if a depositor should die outside of Los Angeles County and in a place where it would not be geographically "practicable for ANGELUS to conduct funeral services for the Applicant", the deposited sum would be payable at the request of the depositor's heirs to any other funeral company the heirs might designate.

Even apart from this, since the modest deposits and payments often left so small a sum paid in at the time of death that in the absence of willingness by the heirs to add further contributions performance by Angelus rendering a funeral and casket "of the reasonable value" of the deposited amount would profit no one, including

Angelus, it was the unvarying practice of Angelus to refund the deposited sum to the heirs should they prefer another funeral director, and request a transfer of the moneys. According to the uncontradicted testimony of Mr. Hill this was never "at any time" refused. [II T. R. 24-25.] The Tax Court found that petitioner "voluntarily refunded" each year under the agreements something approximating 7 to 10 per cent of the amounts paid in under such agreements in such year; in 1960, for example, it refunded $899.85 under such agreements while receiving deposits thereunder of $8,565.00. [I T. R. 28, 35 (fdg.).]

Under the pre-1961 agreement-form Angelus was required during the interim between deposit and the death of the depositor to "deposit all sums paid to it" under the deposit agreement "in a bank, trust company or savings and loan association and . . . not thereafter [to] withdraw such sums, or any portion thereof" except for either performance or refund under the agreement. [Petr's Ex. 10, *supra*, par. 5.] Under paragraph 6, the pre-1961 agreements awarded to Angelus all interest earned upon such deposits as "compensation" for "the collection, custody and conservation of the sums" so paid to it and held by it in trust. [Petr's Ex. 10, par. 6.]

In September 1961 and thereafter the pre-need funeral deposit agreements were altered in a *single respect*. Under the new 1961 agreement-form then established and thereafter followed, although all other terms remained *identical* to the pre-1961 agreement-form and although all deposits were still identically required to be held until the depositor's death "in irrevocable trust", a change was made in the provision requiring the de-

posited funds to be held only in bank accounts. That provision was altered to give Angelus an option to either continue to place the deposit moneys in bank deposits as before or—still subject to "irrevocable trust" —to invest the same in "any capital improvement to then existing mortuary facilities belonging to ANGELUS . . . [or] the acquisition and improvement of real property." [Petr's Ex. 11, *supra,* par. 5.]

To the extent that the foregoing provision in the 1961 agreement-form gave Angelus a power for a partially selfish use, it was compensated for by a payment by Angelus of a form of interest. Under pargraph 6 of the 1961 agreement-form, in consideration for the foregoing right to place interim moneys in trust in improvements to its mortuary facilities or in real property, Angelus agreed to pay each depositor under such agreement each year ten per cent of the amounts deposited by such depositor in such year. As the Tax Court found, these interest payments by Angelus proved an inducement which persuaded numerous applicants holding deposits under the pre-1961 form of agreements to cancel those agreements and substitute agreements under the new 1961 agreement-form. [I T. R. 28, 32 (fdg.); 47 T. C. at p. 393.]

One final circumstance remains to be stated. Under both the pre-1961 and the 1961 agreement-forms performance by Angelus called for the sale of a casket concurrent with the performance of the funeral services provided for, the whole to be in combination "of the reasonable value equal to" the amount of deposited money at the time of death, or in such greater amount as the relatives might agree upon after death. [Petr's Exs. 10 and 11, par. 2.] The uncontradicted testi-

mony of petitioner's president, Mr. Hill, was that one-half of the moneys available was allotted to the casket purchase if no specific casket or price was agreed upon. [II T. R. 26-27.] Thus the deposit agreements called for a future sale of a casket for a price, and at a cost to Angelus, unknown and indeterminable until the time of death.

The Tax Court found that the moneys paid to Angelus under the agreements made under the original pre-1961 agreement-form were received by Angelus as "a true trustee", and that the interest thereunder awarded to Angelus on the interim funds held in the bank accounts was but "the equivalent of a trustee's fee" (having in mind the disproportionate amount of book work for the small deposited sums involved), and, in consequence, that the moneys on deposit were *not* taxable to Angelus as income so long as held thus in such *interim trust*. [I T. R. 28, 36-41; Appendix A, *infra*.] The Court of Appeals, as to this ruling, concurred and affirmed. [I T. R. Supp.; Appendix B, *infra*.]

As to the deposit agreements drawn under the 1961-agreement form, the Tax Court found that although the interim moneys held by Angelus thereunder were still expressly required until the death of an affected depositor to be held "in irrevocable trust" [Petr's Ex. 11, par. 4] and although the 1961 agreements were otherwise in all respects *identical* to the prior agreements in terms and form, the single change under the 1961 agreement-form in the powers granted Angelus respecting the interim deposits to add thereto a power to invest the deposited trust moneys—although in *trust* and as a merely *interim* investment only, not an investment *in fee*—in mortuary improvements or in the

acquisition of real property [Petr's Ex. 11, par. 5], so "effectively destroy[ed]" the "custodial or trust" nature of the interim moneys as to give them in substance to Angelus subject to "no restraint nor limitation" at all, and, in consequence, such interim moneys became taxable to Angelus as income at the time first received. [I T. R. 28, 41-45; Appendix A, *infra.*] The Court of Appeals affirmed, but without joining in the Tax Court's assertion that the investment power granted by the 1961 agreement-form destroyed under trust-law the trust nature and character of the written instrument. It found that "notwithstanding [assumed] power [in] the beneficiaries . . . to enforce the trust terms under state law", Angelus should be taxed upon the deposited moneys under the 1961 agreement-form at the time of receipt because of the extent of "the economic benefit to Angelus" granted thereunder. [I T. R. Supp; Appendix B, *infra.*]

Summary of Argument.

Petitioner submits that under tax fundamentals and long-accepted precedents the deposits paid Angelus under the 1961-agreement-form, and held by it thereunder *in trust* until a depositor's death, were not taxable income at the time of such payment or interim holder because of *two* controlling considerations, and that the Court below has created conflict between the circuits and uncertainties and ambiguities in the basic tax law in its opinion ruling otherwise.

Firstly, the deposited moneys during the interim holding and until a depositor's death were held by Angelus *subject to conditions and contingencies* of such a nature and consequence as to render it unknown and indeterminable during the interim holding whether the

deposited moneys would ultimately become income or not, and established prior precedents have ruled that wherever moneys are paid a taxpayer under premises so characterized by conditions or contingencies during an interim period as to make it unknown whether the sums concerned will ultimately be income or not, or if income, whether ordinary income or capital gains, the moneys thus received are *not* taxable as income to the taxpayer until the point in time at which the taxable nature of the sums becomes known or determinable. The considerations of contingency involved at bar were that either (a) the depositor in a given case might die outside Los Angeles County and where it would not be geographically "practicable" for Angelus to provide funeral services, in which event by the express condition of paragraph 7 of the 1961 agreement-form [Petr's Ex. 11, par. 7] the deposit became repayable to the designee of the depositor's heirs, or (b) the depositor during life might refuse to continue payments (which were *expressly* unenforceable) or might request a partial or total withdrawal of his deposit (which requests were necessarily honored because of the dependency of the program and each deposit upon *voluntariness* for success), or (c) the heirs after death might prefer a different funeral director and request a transfer of the deposit funds to such new director (which requests were likewise unvaryingly honored by force of the voluntariness of the program and the specific circumstance that in many cases the amount paid in at death would be so small that to insist upon performance of the contract and the rendering by Angelus of funeral services and the sale of a casket "of the reasonable value equal to" in combination the

amount paid in at death, without a further agreement and contribution by the heirs, would profit no one, including Angelus).

Secondly, the deposited moneys during the interim holder until a depositor's death were expressly required to be held under written, enforceable terms of *trust* so limiting Angelus' freedom of user and so negating on its part any "claim of right" in fee, as to undergird and reinforce importantly the contingent obligations to account for and pay back the deposited sums above discussed, and thereby to emphasize the nontaxability of the deposited moneys as income during the period of the *interim trust.*

Finally, petitioner calls attention to the circumstance that the Court below, in disallowing the prior lower-court precedents urged by petitioner, found *controlling* at bar this Court's decisions in the trilogy of cases, *Schlude v. Commissioner,* (1963) 372 U.S. 128; *American Automobile Association v. United States,* (1961) 367 U.S. 687; and *Automobile Club of Michigan v. Commissioner,* (1957) 357 U.S. 180. The decision below thereby brings into square issue the questions, heretofore much debated and mooted, whether those decisions reach (a) to advance payments characterized by *contingency* as herein described and/or by a *holding in trust* imposing substantial restrictions on use during interim holder, or (b) to advance deposits upon future sales of goods at prices, and under costs to the taxpayer, unknown and indeterminable in advance.

Petitioner submits it would be in the public interest for this Court to allow certiorari to review and determine the conflicts and questions of law presented herein as above described.

ARGUMENT: REASONS FOR GRANTING THE WRIT.

I.

The Decision Below Creates Conflict Between the Circuits and Divisions and Ambiguities in the Tax Law in Holding Taxable as Income to Petitioner at the Time of Receipt and While Held as Interim Deposits, the Deposit-Moneys Paid at Bar Despite (A) the Circumstance That the Deposits Were Conditional and Contingent in Nature and Left Their Character as Income Versus Returnable Deposits Unknown and Indeterminable During the Deposit Period, and (B) the Further Circumstance That the Contingent Obligation to Repay Was Reinforced by a Requirement That the Interim Deposits Be Held in Unamendable, Written Trust.

The instant case raises anew troublesome divisions and uncertainties in the income-tax law as to the "when" and "how" of taxing as income advance moneys deposited with a taxpayer in connection with agreements for *future* consideration.

Where the future consideration has been contractually sure to occur, and the deposit has been subject to no substantial contingencies either of circumstance or of contract provisions, and the advance payments have been unrestricted as to use, the decisions have largely—and increasingly—held the payments taxable as income at the time of receipt. In illustration, advance deposits of rent, though contractually applicable only to a future month or year, are uniformly held taxable as income at the time of deposit, and this whether the taxpayer accounts on a cash or an accrual basis. (*United States v. Boston Ry. Corp.* (C.A. 1, 1930) 37 F. 2d

670; *Renwick v. United States* (C.A. 7, 1937) 87 F. 2d 123; *Commissioner v. Lyon* (C.A. 9, 1938) 97 F. 2d 70; *Astor Holding Co. v. Commissioner* (C.A. 5, 1943) 135 F. 2d 47, 48.)

However, where the contract and the rendition of the future consideration have been conditional, or subject to contingencies, the interim deposits have been ruled by firm prior precedents—hitherto seemingly well-established—providing that *wherever* moneys are paid to a taxpayer in premises so characterized by conditions or contingencies (whether of contract powers, or of acts or events) as to make it unknown and indeterminable during an interim period whether the moneys will ultimately become taxable as income or not, or if taxable so whether as ordinary income or capital gains, the moneys during such interim period are *not* taxable to the taxpayer as "*income*". And particularly has this been indicated as to contracts for the future sale of goods.

Moreover, while the above mentioned prior precedents establish that the interim deposits in such premises are not taxable as income even where the interim period is of substantial duration and notwithstanding that the taxpayer during such period may hold the sums free of any restriction as to use, in *principle* under these precedents and under tax fundamentals generally, the nontaxability as income of such interim moneys is made particularly plain where the conditional, contingent obligation to repay the sums concerned—which conditional obligation to repay *creates* the consequence of *nontaxability* after the fashion of the absolute duty to repay in the premises of a *loan*—is *reinforced* by a requirement that the interim sums be held *in trust*.

The opinion of the Court of Appeals below creates conflict with these prior precedents and tax principles, and renders uncertain the applicable law.

(A) The Circumstance of Contingent Holding.

Considering first the factor simply of a *contingent* holding of advance deposits, a number of categories of prior precedents attest that where interim moneys are so characterized by conditions or contingencies as to make it unknown and indeterminable during the period of interim holding whether the moneys will ultimately be income to the holder or not, or if income, whether ordinary income or capital gains, the affected sums during such period of uncertainty and contingency are not taxable to the holder as income. Such precedents come from cases dealing with certain option deposits, with certain lease-security deposits, and with certain contract advance payments, as is developed below.

(1) The first category of prior precedents in conflict with the decisions below deals with certain *option-deposits* whereunder the money paid for a purchase-option right, though forfeitable if the option is not exercised, is applicable against the agreed purchase price if the option is exercised. In such cases it is uniformly recognized and held that the seller receives no taxable income at the time of payment or during his interim holding or use of the option money, because until the option is either exercised or suffered to lapse it cannot be told whether his receipt of it will be income to him or not, or if income, whether ordinary income or capital gains. If the option lapses the option money will forthwith accrue to him as ordinary income, but if the option is exercised there will be no income at all in the

absence of a gain, and if a gain occurs it must still be ascertained whether such will be ordinary income or capital gains. (*Virginia Iron, Coal and Coke Co. v. Commissioner* (C.A. 4, 1938) 99 F. 2d 919, 921-922, cert. den. 307 U.S. 630; *Commissioner v. Dill Co.* (C.A. 3, 1961) 294 F. 2d 291, 298-301; *Kitchin v. Commissioner* (C.A. 4, 1965) 340 F. 2d 895, 897-900; *Hunter v. Commissioner* (C.A. 5, 1944) 140 F. 2d 954.)

As the Court in the *Virginia Coal Co.* case aptly stated:

> ". . . It was impossible to determine [at the time of payment] whether [the option moneys] were taxable or not. In the event the sale should be completed, the payments became return of capital, taxable only if a profit should be realized on the sale. Should the option be surrendered it would then become certain, for the first time, that the payments constituted taxable income. Thus it will be readily seen that it was *impossible* to tax these payments in the year in which they were made."
>
> —99 F. 2d 919, 921, emphasis added.

As the Court in the *Kitchin* case observed, the "claim of right" doctrine (*North American Oil Co. v. Burnet,* (1932) 286 U.S. 417) cannot avail the Commissioner because,

> ". . . that doctrine does not apply . . . where the *character of the proceeds is uncertain,* as it is in the present case, so that it remains undetermined throughout the taxable year in which they are accrued *whether the payments will be income at all. De Guire v. Higgins,* 159 F. 2d 921, 924 (2 Cir.), cert. denied, 331 U. S. 858 (1947)."
>
> —340 F. 2d 895, 900, emphasis added.

(2) A second category of precedents conflicting with the decision below deals with certain *lease-security deposits* where the advance deposits secure covenants other than, or in addition to, merely the promise to pay rent. In such cases if the deposit is returnable if no covenant-breach occurs, the deposit cannot be taxed as income when paid down, nor during the period of the lease, because for all that can be known during such period it may be required to be returned to the lessee in full at the end of the lease. (*Warren Service Corp. v. Commissioner* (C.A. 2, 1940) 110 F. 2d 723, 724; *Mantell v. Commissioner,* (1952) 17 T.C. 1143, 1147-1149; Rev. Rul. 67-47, 1967-1 C. B. 9, 10-11; 2 Mertens, *Law of Federal Income Taxation* 365.) This is true, as the *Warren* decision makes clear, even though the lessor has "unrestricted use" of the deposit moneys during the period of the lease, and even though the deposit be large in amount (there $125,000) and even though the period of the lease may run for many years (there 15 years). Throughout all such term the deposit money "[is] not income . . . since the lessor [is] under obligation to repay it" at the end of the lease if no covenant is breached. (110 F. 2d 723, 724.)

Indeed, even if the advance deposit secures the rent for the last month or year of the lease, so long as it secures also *other* covenants as well and is applicable as forfeited damages in the event of breaches thereof, it remains not taxable as income to the lessor during the life of the lease, because even in such premises its income versus nonincome nature remains subject to contingency and in abeyance during the lease period. Even in such a case it cannot be known during the leasehold term whether the deposited sum will ultimately become

rent and thus accrue as ordinary income, or will become taxable or nontaxable damages for a covenant-breach causing injury to, or destruction of, the leasehold premises or to related lessor rights and interests. Thus its taxable nature is *uncertain,* and during the period of uncertainty it is not income despite freedom from restriction as to use. (*Clinton Hotel Realty Corp. v. Commissioner,* (C.A. 5, 1942) 128 F. 2d 968, 969-970; *Commissioner v. Riss,* (C.A. 8, 1967) 374 F. 2d 161, 171-172; *Harcum v. United States,* (E.D. Va., 1958) 164 F. Supp. 650, 651.)

As the Court of Appeals for the Fifth Circuit declared in the *Clinton Hotel* decision, the underlying basis of *non*taxability in these contingent lease-security deposit cases is the parallel which the *contingent* duty of the lessor thereunder to *account* as to the deposited sums bears to a borrower's *absolute* duty to *account* in the case of a *loan.* Both the lessor, in such cases, and a borrower, have free use of the money in the interim, yet because both have obligations (at least contingently) to account, they do not accrue "income". Said the Court in the *Clinton Hotel* decision at page 969:

> "[I]f [the advance lease deposit] was paid and received as security, with no present right or claim of full ownership, it would not be presently income, although it was expected finally to be applied in payment of the last year's rent if nothing happened to prevent. *Barker's Estate v. Commissioner,* 13 B. T. A. 562; *Warren Service Corp. v. Commissioner,* 2 Cir., 110 F. 2d 723. *In the latter situation, though the money is rightfully received, and if the parties so intend may be freely used, yet because of the acknowledged liability to account for it, there is no gain; just as in borrowing there is none.*"
>
> —128 F. 2d 968, 969, emphasis added.

(3) A final category of prior precedents in conflict with the decision below on the score here concerned deals with advance deposits paid under certain executory, contingent and conditional contracts for performance of future services or for future sales of goods, where the advance-payments either (a) have the character of *loan-deposits* paid to aid the seller in the manufacture or acquisition of the goods to be sold, or (b) have the character of *reservation-deposits* paid to insure priority of right in the payor to purchase scarce future goods should such become available, or (c) have the character of *earnest-money deposits* paid by the buyers to evidence serious intent under contracts where either the buyer or the seller, or both, reserve a right of cancellation at any time before actual consummation. In all of these sub-categories of cases advance deposits have been held *not* taxable as income so long as either the contingency of cancellation or of defeasance exists, or the functional character of the deposit as a loan remains extant.

Examples of sub-category (a)—advance sales payments having the character of *loan-deposits*—are found in two landmark, often-cited decisions, *Consolidated-Hammer Dry Plate & Film Co. v. Commissioner,* (C.A. 7, 1963) 317 F. 2d 829 and *Summit Coal Co. v. Commissioner,* (1930) 18 B.T.A. 983. In both of those decisions the goods ordered by the buyer strained seriously the ability of the seller to perform and the advance moneys were paid to the seller to aid in financing his performance, and "repayment" of the advances was to be made by way of credits against regular installment payments the buyers in each case would owe as the purchased goods became available for delivery. Because of

the continuing duty of the seller to account for and repay such advances, a duty owed above and beyond the ordinary obligations a seller would have respecting a normal prepayment, these advances were held *not* taxable as income to the seller when received but taxable so only when "repaid" by way of the earned credits allowed against the buyer's installment obligations as the goods became available for delivery. The genuinly-intended *obligation* by the seller in both cases to *account for and repay* the advances in the manner of a *loan,* was held controlling. A parallel and illuminative decision in the area of leases is found in *Atlantic Refrigerating Company,* B.T.A. Mem., 1942 (P. H.) par. 42,382.

Examples of sub-category (b) above—advance sales payments having the character of *reservation-deposits* —include a familiar nonjudicial example which arises constantly in sports playoff ticket sales, and the judicial decision in one of the most widely-cited precedents in the entire area here concerned, the decision of the Tax Court in *Veenstra & De Haan Coal Co. v. Commissioner,* (1948) 11 T.C. 964.

The ticket sale example arises wherever a person pays a deposit down upon a purchase of a late-game contest in an athletic playoff series which may possibly be decided in a lesser number of games. It is evident that at the time of the original payment the deposits cannot be genuine income because until the contingency as to the number of contests which will be played is resolved, the fact of a sale is in total uncertainty.

The *Veenstra* decision involves an actual illustration of the essential principle. In *Veenstra* a retailer of coal during wartime conditions of scarcity required his potential customers to place deposits down upon orders

for future possible purchases should the seller be able to acquire coal from wholesalers in the future. The seller received the deposits without restrictions as to use, but if the coal ultimately could not be obtained he was obligated to refund the money, without interest, to the depositor. The Tax Court, recognizing that the seller in a classic "sellers' market" of wartime scarcity was simply forcing his would-be customers to pay deposits down as reservations upon possible future sales, held the deposits were not taxable as income to the seller during the interim occurring before delivery or refund. "From the practical standpoint," said the Tax Court "the deposits made with petitioner were equivalent to a forced temporary advance by the customers to petitioner's working capital." (11 T.C. 964, 968.)

Examples of sub-category (c) above—advance contract payments having the character of *earnest-money deposits* where either the buyer or seller, or both, retains a right of cancellation—are found in *Consolidated-Hammer Dry Plate & Film Co. v. Commissioner, supra*; *Woodlawn Park Cemetery Co. v. Commissioner,* (1951) 16 T.C. 1067; *Watkins v. United States,* (C.A. 1, 1961) 287 F. 2d 932; and *Bremerton-Tacoma Stages v. Squire,* (W.D. Wash. 1951) 96 F. Supp. 718.

In the *Consolidated-Hammer* decision the Federal Government was the purchaser and the Tax Court, in its opinion, observed that in addition to the features there present paralleling the qualities of a loan heretofore discussed, it was also true that the purchase contracts could be "unilaterally altered or cancelled" by the Government as the buyer. (21 T.C. Memo. 1962-97, 528, 533.) By force of this feature the Court of Appeals declared that the seller's right to retain any part

of the advance payments concerned there was never more than a "conditional or tentative" right, negating taxability as present income. (317 F. 2d 829, 832.)

In the *Woodlawn Park Cemetery Co.* case advance deposits were paid by purchasers upon contracts for the future sale of mausoleum spaces in a mausoleum proposed for construction. Both the purchasers and the seller retained powers of cancellation; the seller was not obligated to construct the mausoleum although it was expected that he would, and the purchasers were not required under certain conditions to complete the purchase even if the mausoleum were constructed. The Tax Court characterized the deposit payments as being "purely executory" in nature, "mere contingent payments made pursuant to conditional agreements." (16 T.C. 1067, 1078.) Relying upon the *Veenstra* decision, the Tax Court held the transactions constituted "contingent contracts to sell, not completed sales", and held that notwithstanding that the seller received the funds without restriction as to use, the deposits did not constitute taxable income at the time they were paid in nor until a future sale actually occurred. (*Id.*, at p. 1080.)

In *Watkins v. United States* an independent distributor of industrial rubber goods secured an order from a purchaser for a future sale; in order "to guarantee delivery at the existing price" the purchaser "prepaid the sales price." (287 F. 2d 932, 935.) The evidence showed that this purchaser "customarily cancelled orders when his unpredictable season ended." (*Id.*). Relying upon this power of cancellation and upon the authority of the *Veenstra* and *Woodlawn Park Cemetery Co.* decisions, the Court of Appeals for the First Circuit held the deposits constituted "no

taxable income [to the seller] until there [should occur] a completed sale." (*Id.*)

In the *Bremerton-Tacoma Stages* decision the Navy Department, to insure needed transportation for naval personnel and employees in wartime conditions, contracted with a bus company to hold buses available for any transportation needs of such personnel or employees which might arise during a contract period, and the Navy pre-purchased large units of bus tickets in advance by paying a large advance deposit. It was agreed that the deposit for any tickets not ultimately used would be returnable to the Navy at the end of the contract period. It was held that such payments did not constitute income to the bus company at the time of receipt but only as and when transportation services should actually be performed under a ticket so secured by the deposited sums.

(4) Two final circumstances affect the case at bar of importance emphasizing the nonincome character of the deposit payments below under the foregoing several lines of prior precedents.

Firstly, insofar as those decisions have grounded their holdings on the parallel between the contingent obligation to account for and repay the affected deposits there involved and the absolute obligation to account for and repay which obtains in the circumstances of *loans* (*Clinton Hotel; Consolidated-Hammer Co.; Veenstra; Summit Coal Co.;* and *Woodlawn Park Cemetery Co.* cases), the payment of any form of *interest,* where present, has been noted as of importance. As observed in the Statement of the Case, just such a form of interest *was* paid at bar. For the privilege of user

of the deposited funds in the limited manner provided in the 1961 agreement-form, Angelus paid the depositor each year 10% of the moneys paid in by such depositor during such year. Thus the quality of a loan was evidenced. Adverting on the significance of such a provision for interest, the Court of Appeals in the *Clinton Hotel* case involving a security deposit under a lease, observed at page 970:

> "It was intended that the lessor was not to hold it as a special deposit, but might use it as a general deposit, for he was to account for $1,000 per year as interest, in a credit against accruing rents. This does not destroy the character of the deposits as security, but the lessor's accountability for interest as well as for the principal *emphasizes* that character."
>
> —128 F. 2d 968, 970, emphasis added.

Secondly, as also noted in the Statement of the Case, the deposit agreements under the 1961 agreement-form called for the sale of a casket concurrent with the funeral services to be rendered, the whole to be "of the reasonable value equal to" the total deposit moneys paid in at the time of death, or to such amount plus any further amount the heirs might agree to add, if any. According to the uncontradicted testimony, the value of the casket was customarily fixed at one-half of the total moneys available for performance by Angelus. Since this sum could never be known in advance, the deposit agreements under the 1961 agreement-form actually called for future sales of caskets for a sales price, and at a cost to Angelus, neither known nor determinable at any time during the interim holding. In such premises an income tax upon the deposits could not escape

as to one half of the funds the character of a tax upon gross receipts, rather than gross income, for no provision could be made to exclude the return of capital embodied in the costs of the goods sold. Where such a feature has been present, the authorities heretofore discussed have emphasized the impropriety of taxing the interim deposits concerned as "income". (*Veenstra & De Haan Coal Co., supra,* 11 T.C. 964, 967-968; *Woodlawn Park Cemetery Co. v. Commissioner, supra,* 16 T.C. 1067, 1080; *Watkins v. United States, supra,* 287 F. 2d 932, 935.)

(B) The Reinforcing Circumstance of a Required Trust-Holding.

At bar the contingent obligation by Angelus to account for and return to the depositor or his heirs the interim deposit moneys was importantly undergirded and reinforced by the requirement that the moneys be held during the interim period until a depositor's death subject to a written, unamendable, enforceable *trust.* [Petr's Ex. 11, par. 4.]

Even the Tax Court and the Court of Appeals in their decisions below recognized as to the holdings under the pre-1961 agreement-form, whereunder the trust moneys could be held only in trust bank accounts, that a trust holding could negate, or reinforce negating, taxability of the deposit moneys during their interim holding. However, those courts ruled that the power in Angelus under the 1961 agreement-form to invest—still *in trust*—the deposit moneys in mortuary improvements or the acquisition of real property gave Angelus such selfish benefits as to destroy any tax immunity as to the interim holdings under that agreement-form.

This misapprehends the significance of the interim trust holding. The primary significance of the *trust* holding during the interim periods at bar was but to reinforce the contingent obligations of Angelus to account for and repay the deposit moneys to a depositor or his heirs when required so to do under the factors of contingency heretofore treated. Since, as has been already seen, most of the prior precedents heretofore analyzed have held contingent deposit moneys not taxable as income during the interim period of contingency even where the funds are completely unrestricted as to use during such interim, it necessarily follows that *in principle*, and by tax law fundamentals, a *trust* holding of the interim funds can only *strengthen* such tax immunity so far as it substantially restricts the freedom of use of the interim deposits.

The trust-holding of the interim funds at bar has the *purpose* of *insuring* Angelus' capacity at any required time to either perform or repay, as may be required; without such trust security the depositor would have only the business credit of Angelus upon which to depend and an incapacity in Angelus or its assignee to perform or repay at a required time could affect the depositor's heirs at a moment of special need and disadvantage. The trust-holding had the *consequence* of erecting *a law-enforceable limitation* upon the use of the deposited moneys during the period preceding a depositor's death, and this restriction upon use increases the force and significance of the contingent liabilities to account and repay, reinforcing thereby the nontaxability deriving from those contingent duties.

(C) The Conflicts and Uncertainties of Law Created.

All of the foregoing prior precedents and principles of tax law were disallowed by the Court of Appeals in its decision below, the Court distinguishing the same with no sufficient basis or cause. The option-deposit cases the Court of Appeals disallowed as involving "a different problem"; the lease-deposit cases because the depositors at bar "did not pay [the deposits] to Angelus to secure . . . performance of anything, even their obligation to die"; the loan-deposit cases because such were "so different in . . . . facts as not to be analogous"; and the sales cases because the obligation of Angelus "was to furnish funeral services at a future time" (thereby obscuring the circumstance that by the agreement as interpreted by its unvarying conduct Angelus was required also to include with the funeral services a concurrent sale of a casket reasonably proportionate to the deposited moneys). The contention of the petitioner that the deposits were particularly protected from taxability because held in trust was disallowed because only of the power in Angelus under the 1961 agreement-form to invest the interim moneys in mortuary improvements or in the acquisition of real property; no response was addressed either to the circumstance that such trust powers would be guardedly supervised by equity or to the circumstance that such powers in any event left the deposit moneys still restricted by near-absolute, if not absolute, trust limitations as to *interim user,* establishing far clearer and stronger accountability as to the contingent liability to account for and repay the deposited funds than existed in any of the lines of prior precedents relied upon by petitioner.

None of these "distinctions" is well founded and this Court should review and resolve the conflicts and uncertainties of law created by the decision below as abovedescribed.

II.

The Decision Below Creates Further Conflict Between the Circuits and Division as to Basic Tax-Law Theory by Erroneously Extending This Court's Decisions in Schlude v. Commissioner, American Automobile Association v. United States, and Automobile Club of Michigan v. Commissioner to the Trust-Held Interim Deposits at Bar Despite (A) the Trust-Enforceable Restrictions Upon Use of Such Deposits During the Interim Holding Thereof and the Conditional Nature of the Deposit Contract and the Continuingly-Contingent Obligation of Petitioner Thereunder to Account for and Repay the Deposit Moneys, and (B) the Circumstance That the Deposits at Bar Relate in Substantial Part to Future Sales of Goods (Caskets), Not Merely to Future Performance of Services, and During the Interim Deposit Period the Identity of the Goods to Be Sold, the Price for the Sale and the Cost of the Goods Sold Cannot Be Known or Determined.

In distinguishing all of the precedents and principles urged by petitioner as discussed heretofore, the Court below found *controlling authority* in this Court's decisions in the trilogy of recent cases affecting accounting principles and the nondeferment of normal cash prepayments received by accrual-accounting taxpayers, *Schlude v. Commissioner*, (1963) 372 U.S. 128 [hereafter: *Schlude*], *American Automobile Association v. United States*, (1961) 367 U.S. 687 [hereafter: *Ameri-*

can], and *Automobile Club of Michigan v. Commissioner*, (1957) 353 U.S. 180 [hereafter: *Michigan*].

Acknowledging that *Schlude, American* and *Michigan* were not *in se* in point at bar because involving merely the time for accrual by accrual-basis taxpayers of normal, ordinary cash prepayments, and the power of the Commissioner under Section 446(b) of the Internal Revenue Act (26 U.S.C., Sec. 446(b)) to disallow accounting practices found to "not clearly reflect income", the Court below found those decisions nonetheless *controlling at bar* because "the reasons there given in support of [those judgments] are here persuasive." [I T. R. Supp.; Appendix B, *infra.*]

In thus extending to the very different premises involved at bar the "reasoning" of the *Schlude, American* and *Michigan* cases, the Court below brought into open, direct conflict the question whether those decisions apply in whole, in part, or not at all, to (a) prepayment paid in trust and subject to substantial restrictions upon use and/or to conditions or contingencies making it unknown and undeterminable during the period of interim trust holding whether the moneys will ultimately become income or not, or to (b) prepayments paid under contracts for the future *sales of goods* where the price for which the goods will be sold, and the cost of the goods to the seller, are not known nor determinable during the interim period of prepayment.

Virtually *all of the decisions* of the lower courts subsequent to the *Schlude, American* and *Michigan* cases applying or treating of the effect of those decisions have recognized the uncertainty as to the applicability and/or effect of those precedent-making opinions upon prepayments which fall into either one of the two

questioned areas just stated, and all such decisions have consistently *distinguished* and left aside from any expressed statement or ruling of law those mooted areas wherever possible.

The decision below now brings into square conflict and challenge the question whether *Schlude, American* and *Michigan* are applicable to either of those disputed areas, and if applicable what rule of law they establish. Resolution of these questions and uncertainties by this Court would be in the public interest.

(A) As to the first point (category (a) above) of the two stated areas, it is submitted that the Court below clearly erred in extending the nondeferment accounting rule of *Schlude, American* and *Michigan* to the deposit moneys at bar, the same being *trust-held, restricted-use, contingent-right interim deposit holdings*, and this Court should right the error decisively to prevent increasing uncertainty and unclarity in the tax law.

This Court in *Schlude carefully noted* that the dance-lesson prepayments there involved were received by the accrual-basis taxpayer there concerned *"without restriction as to use and without obligation of refund."* (372 U.S. 128, 136, emphasis added.) At another point in the same opinion, this Court further emphasized the distinction by observing that the prepaid amounts there "were *deposited in* the [dance-studio's] *general bank account without segregation* from its other funds." (*Id.*, at p. 131, emphasis added.)

Similarly in the *Michigan* case this Court noted specifically that the prepaid automobile association dues there concerned were "*deposited in a general bank account* and [were] *not segregated* from general funds

but [were] available and . . . *used for general corporate purposes.*" (353 U.S. 180, 188, emphasis added.) Again, in the *American* decision, this Court again specifically noted that the prepaid automobile association dues concerned there were likewise "deposited in the Association's bank accounts *without restriction as to their use for any of its corporate purposes.*" (367 U.S. 687, 690, emphasis added.)

The deliberate care thus manifested by this Court in separating from its decisions in the *Schlude, American* and *Michigan* cases the area of prepayments paid subject to restrictions as to use was noted carefully by the lower courts in all subsequent decisions applying or treating of the *Schlude, American* and *Michigan* cases. Witness the deliberate care with which the subsequent lower-court decisions listed below take note that their premises and rulings, too, do *not* involve prepayments subjected to any restrictions upon use or requiring a holding in trust or as segregated funds:

Parkchester Beach Club Corp. v. Commissioner, (C.A. 2, 1964) 335 F. 2d 478, 480 (noting that the prepayments on rentals of athletic club lockers involved there were not paid or required to be held as "trust funds" but were paid the taxpayer without limitations and the taxpayer "had the complete unrestricted use of the advance payments and comingled them with its own funds.");

Franklin Life Insurance Co. v. United States (C.A. 7, 1968) 399 F. 2d 757, 762 (observing that the prepayments of interest involved there were paid "without restriction upon [their] use by the taxpayer.");

United States v. Williams, (C.A. 5, 1968) 395 F. 2d 508, 510 (noting that the advance rental payments involved there were found by it to have been paid not "as a loan" but "without restriction as to [their] use" and hence taxable under *Schlude* and *American*);

Garber, Inc. v. Commissioner, (1969) 51 T.C. No. 72, 2326, 2327 (noting pointedly that the prepayments made under purchase orders for custom-made fur coats involved there "were received *without restriction as to use or disposition* and were deposited in petitioner's regular bank account and intermingled with other funds.");

Fifth and York Co. v. United States, (W.D. Ky., 1964) 234 F. Supp. 421, 422 (noting that the prepayment there concerned "went into plaintiff's bank account and was used in the regular course of business.");

Modernaire Interiors, Inc., (1968) 1968 T.C.M. No. 252 1459, 1460 (observing that the prepayments deposited with orders for custom-construction of furniture concerned there "were received without restriction as to use or disposition and were used by petitioner in the ordinary course of its business.");

Farrara v. Commissioner, (1965) 44 T.C. 189, 190 (taking note that the cash deposits paid there under the suit lottery and sales-order plan there concerned were received by the taxpayer-seller under "no restrictions as to the use of the receipts . . . [which] are comingled with other funds of the business.").

Of parallel significance and importance as indicating that the *Schlude, American* and *Michigan* decisions are to be separated from tax issues affecting prepayments received and held in trust or subject to substantial restrictions as to use, or subject to conditional or contingent obligations to make repayment, is the further circumstance that many of the lower-court decisions subsequent to the *Schlude* trilogy *carefully distinguish also* the *major case-precedents favorable to and urged by petitioner on such scores at bar,* including *notably* the decisions in the *Veenstra, Consolidated-Hammer, Woodlawn, Watkins,* and *Summit* cases, *supra.** Witness the discussion of, and the careful distinguishing of, these judicial precedents in such post-*Schlude* decisons as the following:

> *Hagen Advertising Displays, Inc. v. Commissioner,* (C.A. 6, 1969) 23 AFTR 2d 69-768, 69-711 (distinguishing the *Consolidated-Hammer, Watkins, Woodlawn* and *Veenstra* cases as all involving deposits which "were received either conditionally or pursuant to a loan-financing arrangement".);
>
> *Garber, Inv. v. Commissioner, supra,* 51 T.C. No. 72 2326, 2328 (distinguishing the *Veenstra* decision);

*These decisions are all discussed under Point I *supra*, and the full citations in the order here listed are: *Veenstra & De Haan Coal Co. v. Commissioner,* (1948) 11 T.C. 964; *Consolidated-Hammer Dry Plate & Film Co. v. Commissioner,* (C.A. 7, 1963) 317 F. 2d 829; *Woodlawn Park Cemetery Co. v. Commissioner,* (1951) 16 T.C. 1067; *Watkins v. United States,* (C. A. 1, 1961) 287 F. 2d 932; and *Summit Coal Co. v. Commissioner,* (1930) 18 B.T.A. 983.

Fifth and York Co. v. United States, supra, 234 F. Supp. 421, 423 (distinguishing the *Consolidated-Hammer, Watkins, Woodlawn* and *Veenstra* decisions);

Modernaire Interiors, Inc., supra, 1968 T.C.M. No. 252 1459, 1461 (distinguishing the *Veenstra, Woodlawn* and *Consolidated-Hammer* cases);

Farrara v. Commissioner, supra, 44 T.C. 189, 192 (distinguishing the *Veenstra* and *Consolidated-Hammer* decisions).

The foregoing citations not only make plain that advance deposits characterized either by contingent obligations to account for and refund the deposited moneys or by requirements for an interim holding in trust, or by both, are distinguishable, in the view of the lower courts, from the *Schlude, American* and *Michigan* rulings, but indicate inferentially that a *contrary* rule should govern these exceptions and they should be, at least within limits, *not* taxable as income when initially paid and while held subject to contingencies and/or trust restrictions.

The question is of importance as is evidenced in part by the number of articles in legal periodicals which have mooted these very questions and projected nontaxability where the deposits are held in trust or subject to substantial restrictions as to use, or subject to contingencies, or are otherwise within the embrace of the prior precedents cited by petitioner and including notably the *Veenstra, Consolidated-Hammer, Woodlawn, Watkins* and *Summit Coal Co.* decisions. (See, for example, the following: Comment, 1967, 24 Wash.

& Lee L. Rev. 291, 293-295; Comment, 1969, 24 Tax L. Rev. 375, 380-381, 397-399, 402; Note, 1968, 46 Taxes 80, 83-84; Article, 1967, 19 U.S.C. Tax Inst. 357, 368-369; Article, 1967, 25 N.Y.U. Tax Inst. 577, 598, 603-606; Comment, 1967, 21 U. of Miami L. Rev. 866, 872, 877, 884; Comment, 1962, 37 N.Y.U. L. Rev. 137, 142; Comment, 1965, 11 Wayne L. Rev. 482, 488.)

(B) As noted in the Statement of the Case, the 1961 deposit agreement at bar involved not only contracts for future funeral services but contracts as well for concurrent future sales of caskets reasonably proportionate in each instance to the deposited money available at death and the accompanying funeral services to be performed. At the time of the deposits, and during the interim holding thereof by petitioner before a depositor's death, the price of the casket to be sold in any individual instance, and the cost thereof, were not known by petitioner nor determinable.

Despite contrary rulings by some lower courts (*Hagen Advertising Displays, Inc. v. Commissioner, supra,* 23 AFTR 2d 69-768, 69-769, 69-772; *Fifth and York Co. v. United States, supra,* 234 F. Supp. 421, 423-424; *Modernaire Interiors Inc., supra,* 1968 TCM No. 252 1459, 1461-1462), taxpayers and many commentaries have raised particularly serious questions as to whether the nondeferment ruling of *Schlude, American* and *Michigan* reaches, or constitutionally even *can* reach, to contracts for future sales of goods, as distinguished from services, where the cost of the goods sold are not known and hence may not be excluded from the impact of the tax. (See, for example, the discussions in such commentaries as the following: Comment, 1969, 24 Tax L. Rev. 375 *et seq.* (entire article); Comment, 1968,

46 Taxes, *supra*, 83, 84; Comment, 1967, 19 So. Car. L. Rev. 176, 187-190; Note, 1968, 54 A.B.A. Journ. 84, 87-88; Comment, 1967, 21 U. of Miami L. Rev. *supra*, 866, 875 *et seq.*; Comment, 1962, 37 N.Y.U.L. Rev., *supra*, 137, 142; Comment, 1965, 11 Wayne L. Rev. *supra*, 482, 488.)

It would be in the public interest for this Court to set at rest the above uncertainties in the law as to the scope and consequence of *Schlude, American* and *Michigan.*

Conclusion.

WHEREFORE, or all of the reasons and upon all of the considerations set forth above, petitioner respectfully prays that a writ of certiorari issue in the within case to review the decision of the Court of Appeals below.

Respectfully submitted,

LEO BRANTON, JR.,
WILLIAM B. MURRISH,
Attorneys for Taxpayer-Petitioner.

APPENDIX A.

(Tax Court Opinion Below.)

Angelus Funeral Home, Petitioner v. Commissioner of Internal Revenue, Respondent.

Docket No. 4217-64. Filed January 17, 1967.

Leo Branton, Jr., for the petitioner.

Richard Eisman, for the respondent.

Forrester, *Judge*: The respondent has determined deficiencies in the petitioner's income tax as follows:

Year	Deficiency
1959	$13,907.77
1960	11,427.51
1961	10,187.28
	36,187.28

Several issues have been settled by the parties leaving for our determination the following:

(1) Whether this petitioner must include as income in the respective year of receipt, moneys paid to it under two forms of written instruments, each denominated "Pre-Need Funeral Plan Agreement"; and

(2) Whether respondent was correct in determining that amounts received under the earlier of such forms of agreement during the years 1954 through 1958, but omitted from income in such years, should be the basis for an adjustment to petitioner's income tax liability for the year 1959 under the provisions of section 481 of the Code.[1]

[1]All Code references are to the Internal Revenue Code of 1954.

Findings of Fact.

Some of the facts have been stipulated and are so found.

Petitioner is a California corporation, the principal business of which was providing funeral and burial services. During the years in issue and at least as far back as calendar year 1954 it filed its income tax returns with the district director of internal revenue at Los Angeles, Calif., on a calendar year, accrual basis.

During the years in issue petitioner entered into written contracts with certain individuals which contracts were designated, and bore the heading, "Pre-Need Funeral Plan Agreement" (hereinafter sometimes referred to as contracts).

Beginning in 1954 and continuing through August 1961 the form of written agreement which was used provided in pertinent part that the applicant (customer) agreed to pay petitioner the total sum of X dollars, said obligation to be discharged by a relatively small downpayment upon the signing of the contract followed by additional payments of relatively small amounts each month thereafter until the total sum had been paid in full. Petitioner agreed that upon proof of the applicant's death it would apply the total amount theretofore paid toward the cost of applicant's funeral according to applicant's instructions which were given at the same time the contract was signed. The contract provided further that if the applicant died at any place where it was not practicable for petitioner to conduct his funeral service that petitioner would transmit said total amount ehretofore paid under the contract to any reputable funeral home which was selected to conduct the funeral service. The contract also provided:

4. The Parties agree that all sums paid by Applicant to ANGELUS shall be held by ANGELUS in irrevocable trust for the uses and purposes herein set forth and set forth in Funeral and Internment Instructions No.—.

5. ANGELUS agrees that it will deposit all sums paid to it under this Agreement in a bank, trust company or savings and loan association and that it will not thereafter withdraw such sums, or any portion thereof, except for the uses and purposes herein set forth; provided that ANGELUS may at its discretion withdraw such sums for the purpose of redeposit in some other bank, trust company or savings and loan association.

6. The Parties agree that in consideration of the services performed and to be performed in the collection, custody and conservation of the sums paid to it by Applicant all interest earned on such sums shall accrue to, and shall become the property of, and payable to ANGELUS, as and when earned.

In about September 1961 petitioner stopped using the form which is described immediately above and began using a form which contained provisions which were identical except for the following:

The total amount paid under the contract by the applicant in any given calendar year was called the "Annual Payment" and—

5. ANGELUS may, at its option (a) deposit all or any portion of the sums paid to it under this Agreement in one or more banks, trust companies or savings and loan associations, or (b) at any time before or after such deposit thereof, use all or any

portion of such sums as collateral or payment for (i) the costs of any capital improvement to then existing mortuary facilities belonging to ANGELUS, and (ii) the acquisition and improvement of real property.

6. In consideration for its right to use the amounts paid hereunder by Applicant in the manner herein provided, ANGELUS agrees to pay to Applicant on or before the 31st day of December of each year an amount equal to ten per cent (10%) of the Annual Payment (as above defined) made by Applicant during such year.

During and after September 1961 some undetermined number of the applicants who had entered into a "Pre-Need Funeral Plan Agreement" with petitioner prior to that time elected to and did sign the new form of agreement in order to be entitled to the payments of 10 percent therein provided for.

During all of the 3 years in issue and for some time prior thereto petitioner maintained a general checking bank account. In addition thereto it maintained a special checking account (designated a clearing account) at Bank of America, and four savings accounts, each in a different savings and loan company, which savings accounts were designated as trustee accounts.

As petitioner collected amounts under the contracts during the years in issue it deposited them in the clearing account and credited a liability account on its books which was designated "Pre-Arranged Funeral Liability." Thereafter at irregular intervals most of these

funds were transferred into one or more of the four trustee savings accounts.

Petitioner did not reflect the amounts collected on the contracts as income in the year the payments were received but returned income from the contracts only when it provided the funeral and burial services upon the death of a particular individual. It did so by debiting the "Pre-Arranged Funeral Liability" account on its books and crediting earned income. Petitioner also reported as income the interest on the four savings accounts as such interest became due and such amounts are not in dispute.

Commencing in 1959 and for the remainder of the years in issue John L. Hill, the president and the owner of all petitioner's stock, personally supervised the operation of petitioner's pre-need funeral plan program and the handling of its funds. Prior to that time these responsibilities had been handled by petitioner's treasurer. Hill, on assuming such responsibilities, discovered that some of the pre-need funds had been deposited in petitioner's general checking account instead of in its special clearing account or any of the trustee savings accounts. Upon making such discovery Hill ordered that such funds be immediately segregated and this was accomplished by means of a check drawn on petitioner's general account and transferring such funds to its trustee savings accounts.

As of January 1, 1959, the balances in the four savings accounts and the clearing account totaled $15,-

609.16, while the ending balance of petitioner's "Pre-Arranged Funeral Liability" account at December 31, 1958, was $24,706.07. Balances of such liability account and the totals in the clearing and savings accounts at the end of each of the years in issue were as follows:

Date	Prearranged funeral liability	Total clearing and savings accounts
Dec. 31, 1959	$30,936.41	$34,100.99
Dec. 31, 1960	39,501.16	40,535.56
Dec. 31, 1961	51,297.77	53,172.68

During the 3 years in issue there were certain transfers from the clearing account to petitioner's general checking account, but during each of such years the total of such transfers was less than the total amount which petitioner declared as income from performances under the contracts plus interest earned on the four savings accounts.

Petitioner was not obligated to refund any moneys collected pursuant to the terms of the contracts but nevertheless it voluntarily refunded the following sums during the years in issue: 1959—$538.09, 1960—$899.85, and 1961—$742.73.

Respondent determined that petitioner's receipts under the contracts for the years in issue were taxable income which it had failed to include in its returns in the respective amounts of: 1959—$6,230.34, 1960—$8,565.00,[2] and 1961—$11,796.61. Respondent further determined that petitioner similarly received and failed to report the amount of $24,705.82[3] during the years

[2]The stipulation indicates that this figure should be $8,564.75.
[3]The stipulation indicates that this figure should be $24,706.07.

1954 through 1958 and that the tax computed thereon under the provisions of section 481 of the Code became a part of petitioner's income tax deficiency for the year 1959 in accordance with said section 481.

Opinion.

Respondent's entire argument under the first issue has as its foundation the conclusion that neither form of "Pre-Need Funeral Plan Agreement" employed by petitioner imposed any limitation upon petitioner's right and power to consider and use payments made under the contracts as and for its own property as soon as they were received.

We observe at the outset that in our view there are great and material differences between the form of contract which petitioner employed until September 1961 (referred to hereinafter as the earlier form) and the form of contract used by petitioner after that date (referred to hereinafter as the later form). We shall consider the two forms of contract in chronological order.

On careful analysis of all of the facts of record we are satisfied that until September 1961, when petitioner changed the form of its written contract, it was a true trustee and had not otherwise received, nor had any right to use, the moneys paid in by its pre-need applicants.

The earlier form contract was a written instrument. On its face it created an irrevocable trust in *haec verba* and even dictated the forms of depositories to be used by petitioner for the funds. It provided that a readily ascertainable amount—the interest earned on deposits—be paid to petitioner. We look upon this as the equivalent of a trustee's fee.

It is true that some benefit was bound to flow to petitioner under this arrangement in that it had secured to itself the right to perform applicant's funeral at some time in the future on condition that the applicant had not moved away in the meantime. We observe that corporate trustees of funded irrevocable deferred-payment trusts habitually secure a similar present benefit without being considered to be in receipt of income (or in receipt of anything) in their entity as opposed to their trust character. It is clear, from the facts of the arrangement under the earlier form of contract, that applicants were true beneficiaries of the trusts which were created. The fact that some incidental and secondary benefit accrued to petitioner is of no moment.

Respondent protests that petitioner had unrestricted control of the funds and unfettered use of them; however, respondent has stipulated that during each of the years in issue, the totals of the transfers to petitioner's general checking account were less than the totals from performances under the contracts plus interest earned on the savings accounts. Of course, this is not conclusive, but it does tend to prove that petitioner did consider itself bound by the express provisions of the earlier form of contract. Of similar import was John L. Hill's action in immediately restoring petitioner's trustee savings accounts to their proper level in 1959 when he discovered that funds had been improperly deposited in petitioner's general account.

Respondent also protests that, under the contracts, and in fact, "There was a complete absence of an independent trustee * * *." If respondent were relying upon unrestricted de facto use of the funds by petitioner for its own purposes this argument would be

meaningful, for that would tend to show that as a practical matter there was no trust. But the facts are otherwise as is demonstrated by the stipulation, *supra,* that the "trust" funds were held inviolate.

We have heretofore considered quite similar factual situations in the cases of *Seven-Up Co.,* 14 T.C. 965, acq. 1950-2 C.B. 4; and *Broadcast Measurement Bureau, Inc.,* 16 T.C. 988. In *Seven-Up Co.* the petitioner manufactured and sold 7-Up extract to various franchised bottling companies from which it received a specified sum per gallon of extract to be spent for national advertising of the product. The amounts received were commingled and deposited by petitioner in its regular business checking accounts but it did segregate and earmark such funds on its books. Such a program was obviously of benefit to the manufacturer as well as to the bottlers for in theory the busines of each would be increased. Respondent's arguments there, as in the instant case, were that the funds had been received and accrued by the manufacturer in each taxable year under a claim of right and without restriction as to use. Such arguments emphasized the commingling of the funds with manufacturers' business receipts. In sustaining the manufacturer's position we said, page 978:

> The commingling of the unexpended portions of the bottlers' contributions in several bank accounts with receipts from petitioner's business did not destroy their identity as trust funds. 54 Am. Jur. 199. Petitioner had on hand at all times cash and securities in excess of the amount of the unexpended funds and its books showed precisely the amounts contributed and unexpended. As custodian of the funds and agent for the bottlers, petitioner was obligated

to expend them for national advertising, and any diversion for corporate or other purposes might be enjoined by the bottlers by a suit in equity. See *Portland Cremation Assn. v. Commissioner,* 31 Fed. (2d) 843; *Charlton v. Chevrolet Motor Co., supra.*

In *Broadcast Measurement Bureau, Inc., supra,* the petitioner engaged in the compilation and distribution of nationwide surveys measuring radio station and network audiences according to a uniform standard. For this purpose it collected subscription fees from individual stations and networks, all of which were not expended during the year of receipt. Respondent's position was the same as it had been in *Seven-Up Co.* and is in the instant case. In sustaining the taxpayer's position we said, page 997:

> We are convinced that the subscription fees to Study No. 1 which petitioner received in the fiscal year ended June 30, 1946, were impressed with a trust upon their receipt to expend them solely to meet the costs of Study No. 1 so that they constituted a trust fund in its hands rather than income. Whether a trust existed with regard to the subscription fees received by BMB in the fiscal year ended June 30, 1946, depends upon the intent of the parties. *No express words of trust were used, but none are necessary. Hibbard, Spencer, Bartlett & Co.,* 5 B.T.A. 464. Close analysis of the subscription contracts entered into between petitioner and subscribing stations and networks, the understanding of the parties with regard to these contracts, and the performance of petitioner in execution of these contracts persuades us that the parties intended that BMB

receive the subscription fees in trust for the subscribers to carry out Study No. 1. We find a reasonable certainty as to the property, the objects and the beneficiaries, and in such a situation no particular form of words is necessary to create a trust. *Chicago, Milwaukee & St. Paul Railway Co. v. Des Moines Union Railway Co.*, 254 U.S. 196. [Emphasis supplied.]

Further, in answer to respondent's objection that the funds had never been segregated and that there was therefore no trust res, we said at page 1001:

Petitioner's books showed the total amount of such fees it received and the unexpended balance thereof at all times. Any improper use of the unexpended balance of these fees by their custodian could have been enjoined by the subscribers to Study No. 1 by a suit in equity. *Portland Cremation Association v. Commissioner*, 31 F.2d 843.

The facts of the instant case are more favorable to petitioner than are the facts of either *Seven-Up Co.* or *Broadcast Measurement Bureau, Inc.*, in that Angelus did segregate the funds into a special clearing account and four trustee savings accounts, and, in the instant case, express words of trust were used, which circumstance was not present in *Broadcast Measurement Bureau, Inc.* Also, see and compare *Mutual Tel. Co. v. United States*, 204 F. 2d 160 (C.A. 9, 1953).

We conclude from all of the above that petitioner received the payments as they were made under the earlier form of contract as a custodian or trustee with

no rights of use as to the funds as such[4] and consequently that it was not in receipt of income as the payments were made. It follows that in the year 1959 petitioner's taxable income was not computed under a method of accounting any different from the method under which its taxable income for the preceding year had been computed and therefore respondent's determination under section 481 must also fail.

We turn now to the later form of contract which petitioner started using in September 1961 and under which petitioner had the right to, at its option (a) deposit the amounts paid in as theretofore, or (b) "at any time before or after such deposit thereof, use all or any portion of such sums as collateral or payment for (i) the costs of any capital improvement to then existing mortuary facilities belonging to Angelus, and (ii) the acquisition and improvement of real property."

It seems quite clear to us that whereas the earlier form of contract created a custodial or trust arrangement, that the above-quoted language from the later form of contract effectively destroys any such possibility as to it, for this language imposes no restraint nor limitation upon petitioner's *right* to use the funds as they are paid in, the only limitation being upon the manner or purpose of such use. We observe further that the permitted purposes (improvement of facilities and acquisition and improvement of land) were both of

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[4]Petitioner's receipts of interest from the trustee savings accounts were returned as income and such amounts are not in dispute.

sole benefit to the petitioner and of no conceivable benefit to the applicants.

It is patent that the title to such improvements and to such land would be in petitioner the same as title to any other of petitioner's properties, and that the values attaching thereto would be properly carried as an asset on petitioner's balance sheets and subject to claims of petitioner's general creditors. Such funds therefore would have lost all character of trust funds and all that remained between petitioner and its applicant would be a unilateral contractual obligation for petitioner to perform, or have performed, the funeral at applicant's death.

Nor do we think the situation is altered by the circumstance that petitioner had not in fact acted under the (b) option above at any time during 1961. Petitioner had the right to do so "at any time before *or after* such deposit," (emphasis supplied) and it is this right to use for its own benefit at any time which effectively prevents the arrangement from being a trust. Trust funds must be impressed with the prescribed duties and obligations when received. It is unimportant that a reserve be set up or that a trust res be later segregated by the recipient of the funds. The mere statement of such a course of action demonstrates that the recipient received such funds with no fetters upon its use of them, and then voluntarily and unilaterally chose to create the reserve or segregate the trust res. Of course, such funds were income to such a recipient when the money was received.

Permitted total invasion of corpus or res by a purported trustee, at any time, and for the sole benefit of such purported trustee (even though it be a restricted form of benefit) is simply another way of saying that something of value has passed to the purported trustee now in return for his unsecured promise to act at a specified time in the future. Such an arrangement is not a trust, and the purported trustee is simply a contracting party. What had been a segregation of the funds under the earlier form of contract became mere window-dressing under the later form of contract.

A comparable situation was dealt with in *Mutual Tel. Co. v. United States, supra,* where the funds were originally received without any rights of use for that taxpayer's benefit, and therefore such funds were not income to it at that time; but later, under an order of the supervising Commission, the taxpayer was given permission to use the funds for one restricted and specified purpose which was of benefit to it. Permission for such use—the establishment of a retirement system for its employees—was properly held to make the funds taxable income to the telephone company at that time.

It seems obvious to us that petitioner's receipts under the later form of contract are subject to the full force of such decisions as *Schlude v. Commissioner,* 372 U.S. 128 (1963); *American Automobile Assn. v. United States,* 367 U.S. 687 (1961); *Automobile Club v. Commissioner,* 353 U.S. 180 (1957), and similar cases, and we so hold. Current receipts from the later form of

contract were fully taxable to petitioner as they were received.

Since both forms of contract were used by this petitioner in 1961 it is necessary for us to allocate the total 1961 receipts of $11,796.61 between the earlier and the later forms of contract, but unfortunately the petitioner has made no attempt to do so. The record shows only that the changeover occurred in September 1961 but the allocation cannot be made strictly upon the basis of the percentage of time in that year that each form was used because there is no showing of the relative amounts of activity before and after the changeover, and in addition the record does show that during and after September 1961 some undetermined number of the applicants who had already signed the earlier form of contract, elected to and did sign the later form.

In this situation we must simply make the best estimate which we can, bearing heavily against the petitioner because the inexactitude of the record is of its making. *Cohan v. Commissioner,* 39 F. 2d 540 (C.A. 2, 1930). Consequently, we conclude and hold that one-half of the 1961 receipts were under the earlier form of contract and one-half under the later form.

Decision will be entered under Rule 50.

APPENDIX B.

(Court of Appeals Opinion Below.)

United States Court of Appeals, for the Ninth Circuit.

Angelus Funeral Home, Petitioner, vs. Commissioner of Internal Revenue, Respondent. No. 22,118-A

[February 10, 1969]

On Petition to Review a Decision of the Tax Court of the United States.

Before: DUNIWAY and ELY, Circuit Judges and TAYLOR,* District Judge.

DUNIWAY, Circuit Judge:

Taxpayer-Petitioner Angelus Funeral Home seeks review of a decision of the Tax Court, 47 T.C. 391 (1967), upholding the Commissioner's determination of certain income tax deficiencies against it for the year 1961. The sole question raised is whether Angelus must treat as income in the year of receipt payments made to it pursuant to a "pre-need funeral plan arrangement." The Tax Court held that it must. We affirm.

Angelus is a California corporation engaged in the business of providing funeral and burial services. It files its income tax returns on a calendar year, accrual basis. As a part of its business operations during the years 1954 and continuing through 1961, Angelus entered into written contracts with individuals. Each agreement, called a "Pre-Need Funeral Plan Agree-

*Honorable Fred M. Taylor, United States District Judge for the District of Idaho, sitting by designation.

ment", provided for payment by the individual of a small down payment at the signing of the contract, and for voluntary payments of additional small amounts each month until a set sum was reached. Angelus agreed that when the individual died it would apply the total amount paid toward the cost of the individual's funeral. If the individual died at a place where Angelus could not perform its services, Angelus was to transfer the entire sum collected by it to a reputable funeral home which would provide the service.

During the years before and including the first months of 1961, Angelus used a form of agreement which provided:

> 4. The Parties agree that all sums paid by Applicant to ANGELUS shall be held by ANGELUS in irrevocable trust for the uses and purposes herein set forth. . .
>
> 5. ANGELUS agrees that it will deposit all sums paid to it under this Agreement in a bank, trust company or savings and loan association and that it will not thereafter withdraw such sums, or any portion thereof, except for the uses and purposes herein set forth; provided that ANGELUS may at its discretion withdraw such sums for the purpose of redeposit in some other bank, trust company or savings and loan association.

Accordingly, Angelus could withdraw the funds only upon proof of the death of the individual, and then could use the funds only to provide funeral services. The interest earned on the deposited money accrued to Angelus as a fee for handling and accounting for the money.

While Angelus reported the interest received from the savings accounts as income, it did not reflect the amounts paid to it under the agreements as income in the year in which the payments were received. Rather, it reported income from the contractual payments only when it was required to fulfill the contractual obligations.

Angelus changed its agreement in September of 1961. The new agreement was similar to the prior form, including the language of paragraph 4, quoted above, except that it provided that:

> 5. ANGELUS may, at its option (a) deposit all or any portion of the sums paid to it under this Agreement in one or more banks, trust companies or savings and loan associations, or (b) at any time before or after such deposit thereof, use all or any portion of such sums as collateral or payment for (i) the costs of any capital improvement to then existing mortuary facilities belonging to ANGELUS, and (ii) the acquisition and improvement of real property.

As consideration for the right to use the payments in the manner provided, Angelus agreed to pay the contracting individual, at the end of each year, ten percent of the funds paid by him to Angelus during that year. Some individuals who had signed the older agreements converted them to the new type in order to receive the ten percent payment.

The Tax Court found that Angelus was a "true trustee" under the older form of agreement, and that it had no right to use the money paid by the contracting individuals. It held that Angelus was not tax-

able in the year of receipt on the payments collected under these agreements. This decision is not now questioned by the Commissioner. The Tax Court, however, found that the form of agreement adopted by Angelus in September of 1961 gave Angelus extensive rights to the payments and thereby destroyed the trust arrangement between the parties. It held that these payments were taxable as received by Angelus. Only Angelus now appeals.

In assessing the 1961 deficiency, the Commissioner did not rely, and he does not now rely, on the power given to him under 26 U.S.C. §446(b) to require a taxpayer to compute taxable income under a method of accounting that, in the Commissioner's opinion, truly reflects income. Nor does Angelus assert that its "method of accounting" (26 U.S.C. § 446(a)) is correct and should therefore be followed. In short, this case is not an accounting case.

Angelus makes two claims: (1) that the payments received under the 1961 agreement were received by it in trust, and were therefore not income to it, and (2) that even if the payments were not received in trust, they were analogous to certain other types of advance payments that have been held not taxable when received, and that the payments received should therefore be held nontaxable as being, in substance, borrowed money.

1. *The trust claim.*

As a general proposition, payments received by a trustee expressly and solely for the benefit of another are not income to the trustee in his individual capacity. *Healy v. Commissioner,* 1953, 345 U.S. 278, 282. The

Commissioner argues that the 1961 pre-need agreements set up a "trust facade" and questions the effectiveness of the 1961 agreements to constitute a trust. But questions of trust validity are not before us in this tax case. This is not a situation in which no funds were paid into the "trust", or where the designated trust funds were commingled with a trustee's general accounts.[1] Rather, our task is to determine whether the economic benefit to Angelus as trustee is such that Angelus should be taxable on receipt of the payments, notwithstanding whatever power the beneficiaries may have to enforce the trust terms under state law. *Gracelawn Memorial Park v. United States*, 3 Cir., 1958, 260 F.2d 328, 332.

Not every receipt of benefits by a trustee subjects him to taxation on payments to the trust. Trustees receive fees for managing trusts without fear of taxation except as to the fee itself. The interest from the pre-need funds which Angelus received as a fee for management and collection services falls into the latter category. Also, a line of cases involving cemetery maintenance or perpetual care trusts recognizes that while the primary beneficiaries are the lot or niche purchasers, the cemetery also benefits from good maintenance of its premises; nevertheless, if the payments into the trust fund cannot be used for the corporate purposes of the trustee cemetery, they are shielded from taxation despite the incidental benefit to the cemetery.[2]

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[1] *Parkchester Beach Club Corp. v. Commissioner*, 2 Cir., 1964, 335 F.2d 478, 480; *Acacia Park Cemetery Ass'n v. Commissioner*, 7 Cir., 1933, 67 F.2d 700.

[2] *Commissioner v. Cedar Park Cemetery Ass'n*, 7 Cir., 1950, 183 F.2d 553; *Portland Cremation Ass'n v. Commissioner*, 9 Cir.,

But in contrast to the perpetual care trust cases, cemetery owners seeking exemption from taxation for payments into trusts for future capital improvements have had very tough sledding indeed. The court in *Mount Vernon Gardens, Inc. v. Commissioner,* 6 Cir., 1962, 298 F.2d 712, summed up the cemetery owner's problem as follows:

> "But the creation of a trust into which a portion of the purchase price is paid is not in and of itself sufficient to prevent the trust money from being treated as income. . . . [T]he decisive feature in each case is the terms and provisions of the particular trust involved. The questions of control by, and inurement to the benefit of, the taxpayer, are of prime importance. In [two prior] . . . cases the Court was of the opinion that the trust funds were available under the terms of the trust to promote future capital improvements in the taxpayer's property, was for the taxpayer's benefit, and accordingly, was taxable income. . . ." (298 F.2d 716.)

The portion of the cemetery lot purchase price in *Mount Vernon* which was allocable to the "Development Trust Fund" was found to be a part of the cemetery's taxable income.[3]

1929, 31 F.2d 843; *Green Lawn Memorial Park, Inc. v. McDonald,* M.D. Pa., 1958, 164 F. Supp. 438, 441, *affirmed* 3 Cir., 1959, 262 F.2d 588; *American Cemetery Co. v. United States,* D.Kan., 1928, 28 F.2d 918; *Troost Avenue Cemetery Co. v. United States,* W.D. Mo., 1927, 21 F.2d 194; *cf. Oak Woods Cemetery Ass'n v. United States,* 7 Cir., 1965, 345 F.2d 361; *Monte Vista Burial Park, Inc. v. United States,* 6 Cir., 1965, 340 F.2d 595.

[3]Like results have been reached on similar facts in *Jefferson Memorial Gardens, Inc. v. Commissioner,* 5 Cir., 1968, 390 F.2d 161, 167; *Sherwood Memorial Gardens, Inc. v. Commissioner,* 7 Cir., 1965, 350 F.2d 225; *Gracelawn Memorial Park, Inc. v. United States,* 3 Cir., 1958, 260 F.2d 328; *National Memorial Park v. Commissioner,* 4 Cir., 1944, 145 F.2d 1008.

The capital improvement trust cases are applicable by analogy to the facts at hand. The 1961 form of Angelus' pre-need agreement gave Angelus the power to use the funds whenever it wished, subject only to limitations of purpose, *i.e.*, land acquisition or improvement of mortuary facilities. These purposes would benefit Angelus, on the agreeing individuals who are beneficiaries under the trusts. Further, all of the trust funds are subject to Angelus' power. Thus, even assuming that an equity court would enforce the trust terms, the absolute power to benefit itself inhering in Angelus' position as trustee makes it liable for taxation on receipt of the pre-need payments. The trust permits Angelus to benefit itself more than incidentally, and therefore the trust does not operate to shield Angelus from taxation until Angelus acquires a completely unfettered control over the pre-need payments.

Our decision in *Portland Cremation Ass'n v. Commissioner*, 9 Cir., 1929, 31 F.2d 843, does not hold otherwise. There a trust was inferred from sale of cemetery niches with an accompanying covenant that a permanent fund would be established that could only be used for maintenance purposes. The court found that purchasers could invoke equitable remedies to prevent diversion of the fund to the trustee cemetery for corporate purposes. In the present case, however, the instrument creating the trust grants specific powers to the trustee to use the funds for its own purposes, and in an action to enforce the trust we presume that a

court would enforce these grants as it would any other term of the trust.

2. *The "borrowed money" analogy.*

Angelus argues that three lines of decisions support its claim that the payments in question are not income when received, but are in the nature of borrowings. Whether the lender is the individuals who pay or the trust is not made clear. But in any event we do not find these authorities persuasive.

The first line of cases deals with deposits by a tenant of money to be held by a landlord as security for the tenant's performance of a lease.[4] The analogy is not persuasive. The prospective decedents certainly did not pay the money to Angelus to secure their own performance of anything, even their obligation to die. That obligation was scarcely owing to Angelus; we need not attempt to decide to what power, if any, it was owed.

The second line of cases deals with moneys paid to sellers on account of the price of goods to be delivered at a later date. One of them. *Consolidated-Hammer Dry Plate & Film Co. v. Commissioner,* 7 Cir., 1963, 317 F.2d 829, held that advance payments by the government to a small manufactuer-seller for the manufacture and sale of a large custom-made camera had the attributes of a financing arrangement in the nature

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[4] *Clinton Hotel Realty Corp. v. Commissioner,* 5 Cir., 1942, 128 F.2d 968 is principally relied upon. Also cited are *Commissioner v. Riss,* 8 Cir., 1967, 374 F.2d 161; *Zaconick v. McKee,* 5 Cir., 1962, 310 F.2d 12 (bankruptcy proceeding); *Warren Service Corp. v. Commissioner,* 2 Cir., 1940, 110 F.2d 723.

of a loan. We do not quarrel with the decision. But we find it so different in its facts as not to be analogous. *Summit Coal Co.*, 1930, 18 B.T.A. 983, and *Bremerton-Tacoma Stages, Inc. v. Squire*, W.D. Wash., 1951, 96 F.Supp. 718, are similar. Compare *Van Wagoner v. United States*, 5 Cir., 1966, 368 F.2d 95; *Astor Holding Co. v. Commissioner*, 5 Cir., 1943, 135 F.2d 47, which seem to us more closely analogous to the present case.

Also relied upon are cases dealing with sales of goods such as *Veenstra & DeHaan Coal Co.*, 1948, 11 T.C. 964, or of cemetery lots in areas not yet developed, *Woodlawn Park Cemetery Co.*, 1951, 16 T.C. 1067. Here, however, Angelus' obligation was to furnish funeral services at a future time.[5] Under these circumstances, we think that the reasoning of the Supreme Court in *Schlude v. Commissioner*, 1963, 372 U.S. 128, is applicable here. See also *American Automobile Ass'n v. United States*, 1961, 367 U.S. 687, *Automobile Club of Michigan v. Commissioner*, 1957, 353 U.S. 180. It is true that those cases involved the power of the Commissioner under 26 U.S.C. § 446(b), while that power is not in issue here. But the reasons there given in support of the exercise of that power are here persuasive. *Cf. Artnell Co. v. Commissioner*, 7 Cir., 1968, 400 F.2d 981.

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[5]Angeles refers to an obligation to sell a casket, but that obligation is contingent upon payment of the full cost of the "funeral services," and the contract refers to Angelus' obligation to "use," not to "sell" a casket.

The third line of cases involves payments by a prospective buyer for an option to be applied to the price if the option be later exercised.[6] Those cases, however, involve a different problem. If the option is allowed to lapse, the money becomes ordinary income to the optionor; if the option is exercised, the money is received as part of the price of a capital asset, taxable, if at all, as capital gain. The taxpayer (optioner-seller) cannot know which type of income he has when he receives the payments. No such uncertainty as to the character of the money received is here involved.

We hold that the payments here involved were neither loans nor sufficiently analogous to loans to be nontaxable when received.

Affirmed.

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[6] *Kitchin v. Commissioner,* 4 Cir., 1965, 340 F.2d 895; *Commissioner v. Dill Co.,* 3 Cir., 1961, 294 F.2d 291; *Virginia Iron Coal & Coke Co. v. Commissioner,* 4 Cir., 1938, 99 F.2d 919.

APPENDIX C.

(Statute Involved.)

Section 61 of the Internal Revenue Act of 1954, as amended, 26 U.S.C. Section 61, reads as follows:

§ 61. Gross income defined

(a) General definition.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance payments;

(9; Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust.

(b) Cross references.—

For items specifically included in gross income, see part II (sec. 71 and following). For itsm specifically excluded from gross income, see part III (sec. 101 and following).

Aug. 16, 1954, c. 736, 68A Stat. 17.

APPENDIX D.

(Pre-1961 Agreement-Form.)
(Petitioner's Exhibit 10.)

ANGELUS PRE-NEED FUNERAL PLAN AGREEMENT.

This is an Agreement between ..... who is called Applicant, and ANGELUS FUNERAL HOME, which is called ANGELUS, and is entered into between the Parties in order to effectuate the terms of ANGELUS PRE-NEED PLAN Funeral and Interment Instructions No. P 161, dated June 12, 1959.

FOR AND IN CONSIDERATION of the mutual covenants and promises herein contained, and contained in Funeral and Interment Instructions No. P 161, the Parties agree as follows:

1. The Applicant agrees to pay to ANGELUS the total sum of $465.00, to be paid as follows: $2.00 upon the signing of this Agreement, receipt of which is hereby acknowledged, and the sum of $5.00 or more per month on the 12th day of each month hereafter beginning on July 12th, 1959 until the said sum is paid in full. Applicant agrees that he will not assign said sum or any portion thereof without the written consent of ANGELUS, and that any attempted assignment of said sum or any portion thereof without such written consent shall be void.

2. ANGELUS agrees that upon proof of death of the Applicant, it will apply the sum theretofore paid by Applicant toward the Total Cost of Funeral Services as that term is defined in Funeral and Interment Instructions No. P 161; that it will provide funeral services of the reasonable value of the sum theretofore paid to it and that it will otherwise fully and faithfully

follow all directions contained in said Instructions and do and perform all things therein directed to be done and performed.

3. The Parties agree that nothing herein contained shall be construed to vest in ANGELUS the right to sue for or otherwise demand payment of any sum agreed to be paid by Applicant hereunder which is unpaid at the date of his death, and further that neither the heirs nor the personal representatives of the Applicant shall make or assert any demand for funeral services for Applicant of a value in excess of the amount actually paid hereunder by Applicant; provided that nothing herein contained shall be deemed to limit the right of ANGELUS and such heirs or personal representatives to contract for funeral services in any amount in excess of the Total Cost of Funeral Services, or the amount paid on account thereof, that may be mutually agreed upon between them.

4. The Parties agree that all sums paid by Applicant to ANGELUS shall be held by ANGELUS in irrevocable trust for the uses and purposes herein set forth and set forth in Funeral and Interment Instructions No. P 161.

5. ANGELUS agrees that it will deposit all sums paid to it under this Agreement in a bank, trust company or savings and loan association and that it will not thereafter withdraw such sums, or any portion thereof, except for the uses and purposes herein set forth; provided that ANGELUS may at its discretion withdraw such sums for the purpose of re-deposit in some other bank, trust company or savings and loan association.

6. The Parties agree that in consideration of the services performed and to be performed in the collection, custody and conservation of the sums paid to it by Applicant all interest earned on such sums shall accrue to, and shall become the property of, and payable to ANGELUS, as and when earned.

7. The Parties agree that in the event Applicant dies in any city, county, state or territory in which it is not practicable for ANGELUS to conduct funeral services for the Applicant, that ANGELUS will, upon the written request of any heir, executor, administrator, devisee or legatee of the Applicant, pay such sums as may have come into its hands by virtue of this Agreement, to any reputable funeral home selected by the person making the request for such payment; provided that such payment shall relieve ANGELUS of all further responsibility under the terms of this Agreement and provided further that ANGELUS shall be the sole and exclusive judge of whether or not it is practicable for it to conduct such funeral services.

8. The Parties agree that ANGELUS may at its discretion assign the benefits of this Agreement or this Agreement itself, together with Funeral and Interment Instructions No. P 161, to any person, firm or corporation it may select; provided that such assignment shall be conditioned upon a faithful performance of the terms of this Agreement.

Dated: June 12th, 1959.

Applicant
ANGELUS FUNERAL HOME
By: ILLEGIBLE

APPENDIX E.

(1961 Agreement-Form.)
(Petitioner's Exhibit 11.)

FUNERAL & INTERMENT INSTRUCTIONS.

of

.....

Pursuant to the provisions of Section 7100 of the Health and Safety Code of the State of California and for the purpose of relieving my survivors of the burdens of making such decisions and arrangements, I herewith execute the following instructions regarding my funeral services:

1. I direct that my remains shall be delivered to, and that funeral services for me shall be conducted by, ANGELUS FUNERAL HOME, or its successors or assigns.
2. I direct that my funeral arrangements be made in accordance with the Pre-Need Funeral Plan Agreement hereinafter set forth, and that the amount of the "Total Funeral Cost" as used in said Agreement, excluding the cost of a grave, shall be $.....
3. I desire ..... clothing and prefer ..... color.
4. My preference for cemetery arrangements is as follows: .....
5. Fraternal organizations to be notified: .....
6. My church affiliation is .....
7. I would prefer as clergyman .....
8. I wish the following music .....
9. Other instructions or remarks: .....

DATED: ....., 19.....

.....

Applicant

PRE-NEED FUNERAL PLAN AGREEMENT.

Angelus Funeral Home ("Angelus") and .....
..... ("Applicant") agree as follows:

1. Applicant agrees to pay to ANGELUS the amount of the Total Funeral Cost set forth in the foregoing Instructions at times and in amounts as follows: $..... upon the execution hereof, receipt of which is acknowledged by ANGELUS and $..... on the ..... day of each month beginning ....., 19....., until the said Total Funeral Cost is paid in full. The total amount paid by Applicant in any given calendar year on account of the Total Funeral Cost will herein be called "Annual Payment".

2. ANGELUS agrees that, upon proof of death of Applicant, it will fully and faithfully comply with Applicant's foregoing Instructions and will provide funeral services of the reasonable value equal to the total amount theretofore paid by Applicant on account of the Total Funeral Cost. If the full amount of the Total Funeral Cost has been paid, ANGELUS agrees to use casket number .....,
Color ....., Interior .....,
or equivalent, for such funeral.

3. The Parties agree that nothing herein contained shall be construed to vest in ANGELUS the right to sue for or otherwise demand payment of any sum payable by Applicant under the terms hereof which is not voluntarily paid by him, and further that neither the heirs nor the personal representatives of the Applicant shall make or assert any demand upon ANGELUS to provide funeral serv-

ices for Applicant of a value in excess of the amount actually paid by Applicant under this Agreement; provided that nothing herein contained shall be deemed to limit the right of ANGELUS and such heirs or personal representatives to contract for funeral services of a value in excess of the amount paid hereunder by Applicant prior to his death.

4. All amounts paid hereunder by Applicant shall be held by ANGELUS in irrevocable trust for the uses and purposes herein provided, and in consideration of the services to be performed hereunder by ANGELUS, including the custody and conservation of the sums paid to it by Applicant, it is agreed that all income earned on the sums so paid shall accrue to and shall become the property of and payable to ANGELUS, as and when earned.

5. ANGELUS may, at its option (a) deposit all or any portion of the sums paid to it under this Agreement in one or more banks, trust companies or savings and loan associations, or (b) at any time before or after such deposit thereof, use all or any portion of such sums as collateral or payment for (i) the costs of any capital improvement to then existing mortuary facilities belonging to ANGELUS, and (ii) the acquisition and improvement of real property.

6. In consideration for its right to use the amounts paid hereunder by Applicant in the manner herein provided, ANGELUS agrees to pay to Applicant on or before the 31st day of December of each year an amount equal to ten per cent (10%) of the Annual Payment (as above defined) made by Applicant during such year.

7. It is agreed that if the Applicant dies in any city, county, state or territory in which it is not practicable for ANGELUS to conduct funeral services for the Applicant, that ANGELUS will, upon the written request of the personal representative or any heir of the Applicant, pay such sums as may have come into its hands by virtue of this Agreement to any reputable funeral home selected by the person making the request for such payment; provided that such payment shall relieve ANGELUS of all further responsibility under the terms of this Agreement and provided further that ANGELUS shall be the sole and exclusive judge of whether or not it is practicable for it to conduct such funeral services.

8. Applicant agrees not to assign his interest hereunder without the written consent of ANGELUS, and any assignment without such consent shall be void. ANGELUS, however, shall have the right to assign its interest under this Agreement to any person, firm or corporation provided such assignment shall be conditioned upon the faithful performance of this Agreement and the foregoing Instructions by the assignee.

Dated ....., 19.....

ANGELUS FUNERAL HOME

By .....

Applicant

Address .....

Telephone .....

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FILED
JUN 16 1969
JOHN F. DAVIS, CLERK

No. [redacted] 152.

In the Supreme Court of the United States

OCTOBER TERM, [redacted] 1969

ANGELUS FUNERAL HOME, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

ERWIN N. GRISWOLD,
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Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 1434

ANGELUS FUNERAL HOME, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (Pet. A1–A15) is reported at 47 T.C. 391. The opinion of the court of appeals (Pet. B1–B10) is reported at 407 F. 2d 210.

JURISDICTION

The judgment of the court of appeals was entered on February 10, 1969. Petitioner's petition for rehearing was denied on February 27, 1969. The petition for a writ of certiorari was filed on May 24, 1969. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether prepayments received by the petitioner corporation from customers under a "Pre-Need Fu-

neral Plan Agreement", which authorized petitioner at its option to use the prepayments for its own benefit, were includible in its gross income for the taxable years in which received.

STATUTE INVOLVED

The pertinent provisions of Sections 61, 441, 446 and 451 of the Internal Revenue Code of 1954 are set forth in the Appendix, *infra*, pp. 8–9.

STATEMENT

Petitioner, Angelus Funeral Home, is a California corporation engaged in the business of providing funeral and burial services. It files its income tax returns on a calendar year, accrual basis. As a part of its business during the years 1954 and continuing through 1961, petitioner entered into written contracts with individuals. Each agreement, called a "Pre-Need Funeral Plan Agreement", provided for a small down payment at the signing of the contract, and for voluntary payments of additional small amounts each month until a set sum was reached. Petitioner agreed that when the individual died it would apply the total amount paid toward the cost of the individual's funeral. If the individual died at a place where petitioner could not perform its services, petitioner was to transfer the entire sum collected by it to a reputable funeral home which would provide the service. (Pet. A2, B1–B2.)

The payments in issue were paid under a form of agreement, utilized in September 1961 and thereafter, which provided (paragraph 4) that petitioner would hold the sums received "in irrevocable trust." (Pet.

A2–A3, B2–3.) However, the agreement further provided (paragraph 5) that petitioner "at its option," could (Pet. A3–A4, B3)—

> use all or any portion of such sums as collateral or payment for (i) the costs of any capital improvement to then existing mortuary facilities belonging to ANGELUS, and (ii) the acquisition and improvement of real property.

As consideration for the right to use the payments, petitioner agreed (paragraph 6) to pay the contracting individual, at the end of each year, ten percent of the funds paid during that year. Some individuals who had signed previous agreements converted them to the new type in order to receive the ten percent payment. (Pet. A4, B3.) [1]

Petitioner did not report the amounts paid to it under the agreements as income in the year in which the payments were received. Instead, it reported the income only when it was required to fulfill its contractual obligations (Pet. A5, B3–B4). The Tax Court, sustaining the Commissioner's determination, found that the agreement petitioner had adopted in September 1961 gave it an unrestricted right to use the payments for specified purposes beneficial to it, and accordingly held that such payments were taxable in the years received (Pet. A12–A15). The court of appeals affirmed (Pet. B1–B10).

---

[1] An earlier agreement, not in issue, did not contain paragraphs 5 and 6 of the agreement here in issue (Pet. A3, B2). The Tax Court found that taxpayer was a true trustee under this earlier agreement, and that therefore amounts received under that agreement were not taxable in the year of receipt (Pet. A11–A12, B3–B4). The Commissioner did not appeal from the Tax Court's decision.

ARGUMENT

The decision below, affirming that of the Tax Court, turns upon the construction of a service contract between petitioner and its customers, and is in accord with established tax accounting principles governing the proper taxable year for reporting advance payments received for services to be performed. There is no conflict of decisions, or other occasion for further review by this Court.

1. It is axiomatic that taxable income must be computed on an annual ("taxable year") basis, and that therefore a taxpayer (whether reporting on the cash or accrual method of accounting) who receives income without restriction as to its use must report it in the year received even though he may later be required to restore the income. Sections 441 and 451, Internal Revenue Code of 1954, Appendix, *infra*, pp. 8–9; North *American Oil* v. *Burnet*, 286 U.S. 417; *Security Mills Co.* v. *Commissioner*, 321 U.S. 281; *United States* v. *Lewis*, 340 U.S. 590; *Healy* v. *Commissioner*, 345 U.S. 278. It is equally settled, as a corollary of the annual accounting rule, that prepayments for future services or goods, received without restriction as to their use, are reportable in the year of receipt notwithstanding that the recipient taxpayer is contractually obligated to perform the services or deliver the goods in a later year in consideration for the prepayments. *American Automobile Assn.* v. *United States*, 367 U.S. 687; *Schlude* v. *Commissioner*, 372 U.S. 128; *Hagen Advertising Displays, Inc.* v. *Commissioner*, decided March 3, 1969 (69–1 U.S.T.C., par. 9254). Cf. *Franklin Life Insurance*

Co. v. *United States*, 399 F. 2d 757 (C.A. 7), certiorari denied, 393 U.S. 1118.

After analyzing the two types of funeral service contracts ("Pre-Need Funeral Plan Agreement") between petitioner and its customers—those entered into before September 1961 and those entered into afterward—the Tax Court concluded that prepayments under the earlier type (not involved on this appeal) were received and held in trust by petitioner for the benefit of the customer until his death and hence were not reportable in the year of receipt, but that prepayments under the later type of agreement (here involved) were not so received and held and therefore were reportable in the year of receipt. Petitioner's contention that the courts below erred in treating the later prepayments as includible in petitioner's gross income for the year of receipt disregards both the terms of the later agreement and the controlling decisions. The later agreement, as distinguished from the earlier one, imposed no restraint upon petitioner's right to use the prepaid funds for designated purposes beneficial to it (acquisition or improvement of land and other facilities); on the contrary, it expressly granted petitioner the "option" to use the funds for such purposes. (Paragraphs 5–6; Pet. A3–A4, B3.) The mere recitation elsewhere in the agreement that the funds were to be held "in trust" (paragraph 4) must be read in conjunction with the broad option granted to use the funds for petitioner's own benefit; and when so read it becomes clear, as both courts below pointed out, that petitioner had the right to use the funds at any time for its own benefit under the later agreement. If any

doubt otherwise existed regarding petitioner's right to use the prepayments for its own benefit, it is dispelled by petitioner's obligation under the agreement to pay its customers ten percent of the prepayments "in consideration for its right to use" the prepayments. (Pet. A4, B3.)

2. The decision below is not in conflict with any other decision. Cases involving option payments applicable against the purchase price if the option is exercised, upon which petitioner chiefly relies (Pet. 14–15), present the question whether the option payment is to be treated by the optionor as ordinary income or as part of the capital gain on the sale—the determination of which must await the exercise or nonexercise of the option. The question here is not whether an option payment represents ordinary income or capital gain, but when (*i.e.*, in which taxable year) a prepayment of ordinary income under a service contract must be reported.

The "security deposit" cases upon which petitioner also relies (Pet. 16–17), involve the receipt and deposit of monies in trust. They apply to the funds petitioner received under the earlier (pre-September 1961) agreements, as to which the Tax Court ruled in petitioner's favor, not to the prepayments received under the later and different agreements involved on this appeal. As for the "borrowed money" cases relied upon (Pet. 18–22), the assertion of conflict rests upon the self-serving premise—contrary to the concurrent findings of both courts below—that the prepayments in question constituted loans from peti-

tioner's customers, rather than advance payments for services.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.
JOHNNIE M. WALTERS,
Assistant Attorney General.
HARRY BAUM,
BENNET N. HOLLANDER,
Attorneys.

JUNE, 1969.

APPENDIX

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED.

(a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

* * * * *

[26 U.S.C. 1964 ed., Sec. 61.]

SEC. 441. PERIOD FOR COMPUTATION OF TAXABLE INCOME.

(a) *Computation of Taxable Income.*—Taxable income shall be computed on the basis of the taxpayer's taxable year.

(b) *Taxable Year.*—For purposes of this subtitle, the term "taxable year" means—

(1) the taxpayer's annual accounting period, if it is a calendar year or a fiscal year;

* * * * *

[26 U.S.C. 441.]

SEC. 446. GENERAL RULE FOR METHODS OF ACCOUNTING

(a) *General Rule.*—Taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books.

(b) *Exceptions.*—If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of

the Secretary or his delegate, does clearly reflect income.

(c) *Permissible Methods.*—Subject to the provisions of subsections (a) and (b), a taxpayer may compute taxable income under any of the following methods of accounting—

(1) the cash receipts and disbursements method;

(2) an accrual method;

(3) any other method permitted by this chapter; or

(4) any combination of the foregoing methods permitted under regulations prescribed by the Secretary or his delegate.

* * * * *

[26 U.S.C. 446.]

SEC. 451. GENERAL RULE FOR TAXABLE YEAR OF INCLUSION.

(a) *General Rule.*—The amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

* * * * *

[26 U.S.C. 451.]

U.S. GOVERNMENT PRINTING OFFICE: 1969